



ZdravReform
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Trip Report 0866

Accounting, Auditing, Internal Control, and Management Systems:

***A Prefatory Appraisal of the Strengths and Weaknesses
with Recommendations for the Karakol IDS MHIF***

***With training notes on working with the
Federal Health Insurance Fund of Kazakhstan***

Prepared by
Bradford C. Else

submitted by the ZdravReform Program to
USAID/ENI/HP/HR

AID Contract No. CCN-004-C-4023-00
Managed by Abt Associates Inc.
with offices in Bethesda, Maryland, U.S.A.
Moscow, Russia; Almaty, Kazakhstan; Kiev, Ukraine

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*** The footnotes in this document are an integral part of the report.

EXECUTIVE SUMMARY

This report summarizes field work accomplished in Karakol. The work was a rapid yet pragmatic appraisal of the underlying accounting, audit, internal control and management systems of the Mandatory Health Insurance Fund (MHIF).

The current financial reporting system is not easily producing useful management information. This translates to a fundamental recommendation of this field work: *The current retrospective historical financial accounting system geared toward tabulation and regulated reporting needs to be turned around into a forward looking prospective accounting information system geared toward decision-making on a consistent and periodic basis.*

Essential to this effort are six recommendations:

1. Initial and periodic follow-up training oriented toward management accounting, including how to create and apply accounting information for decision-making. This would include the eventual production of a basic set of reports addressing budgeting, cost accounting, and performance management for both the MHIF and component providers.
2. A computer capability which first mimics the key underlying functions of the current balance sheet accounting system and adds selected features and functions to improve the underlying capability to create and report on the financial status of the entity. This would include improved accounting for receivable and payable accruals, accounting for contingencies and other estimates of risk, accounting for and reporting cash and cash compared to current commitments, and creating an improved set of internal and external financial statements. This will minimize double work and facilitate more consistent periodic reporting.
3. Creating and implementing internal control policies and procedures. Current internal control policies, per say, do not really exist. What does exist could be called "external control policies." They are not sufficient to create a control environment which will enhance the operation of the MHIF.
4. Establishing and implementing an internal audit methodology to periodically check for internal control compliance and fraud. The internal audit methodology should supplement the external audits required by law.
5. Implementation of all of the above occur through a few "pilot" Family Group Practices during a 90 day period before roll-out to the entire oblast. This means the "pilot" facilities would act a platform for the cooperative creation and testing of accounting, internal control, auditing and management systems prior program expansion. This is viewed as a prudent, but rapid manner to implement. There appears to be little financial or political room for error.
6. The "un-mingling" of Oblast Health Authority funds and authority from the MHIF as soon as reasonably possible. The current situation allows for a mixed approach and hampers accounting, controls, management systems, and the

staffing needs required to support the operation. This recommendation suggests separating the MHIF entity from the Oblast Health Authority.

The MHIF has an accounting system. The system is structured around traditional Soviet-styled financial accounting requirements and regulatory framework, and managed by personnel with university-level training under Soviet methods. However, because the MHIF is not operating other than as a source of funds for some payroll expenditures, in actuality, the MHIF accounting system is still trying to be "born." Hampering progress is the MHIF staff "waiting" for the authorities to produce regulations dictating what forms they should fill out as well as what controls will be required. Meanwhile, the "authorities" are also waiting for the MHIF to be implemented. This consultant's field work was also directed at advancing progress in this regard. An overview of recommendations, recommended staffing, and suggested timeframes for working through these issues can be found at the very end of this document in Appendix J.

1.0 BACKGROUND

The *ZdravReform* Program has operated in Central Asia since June 1994, when the regional office was established in Almaty. During the last two years it has developed a program to address fundamental problems in the health sector: *under financing and inefficiency*. In the context of the opportunities and constraints in Central Asia, the strategy of *ZdravReform* has been to work intensively in selected oblasts to comprehensively restructure the health system through targeted technical assistance and training.

The basis for this field work began with a twofold interest by the *ZdravReform* program staff in Almaty. First, the program staff wanted to obtain specific financial management assistance that would directly facilitate their program implementation initiatives. Second, they wanted to leverage the technical assistance and experience provided in other parts of the NIS with the current needs of the program effort in Central Asia.

The field work was aimed at rapidly reviewing key underlying financial structures and functions¹ that would eventually be called upon to support a number of current reform initiatives in Kyrgyzstan including:

- *Diversifying health care financing by providing assistance to the national health insurance program.* In Central Asia, *ZdravReform* has provided ongoing technical assistance to develop the legal, regulatory, institutional, and technical framework for the implementation of national health insurance. The Program has worked with national officials to design health insurance legislation and related guidelines and regulations, develop realistic minimum guaranteed benefits packages, and establish Federal MHI Funds. The Program is assisting the MOH and MHIF to diversify sources of funding for health care while maintaining a single payer for health services, which

¹ The topics of the field work were financial accounting, internal control, auditing, and management systems in general.

provides the organizational structure necessary to introduce incentive-based payment methods.

- *Designing and implementing incentive-based provider payment systems.* The allocation of health resources in Central Asia has followed the traditional Soviet chapter budgeting process, allocating health funds across facilities by input measures such as the number of beds, rather than by the quantity and quality of services delivered. The budgets were disbursed by budget chapters according to strict norms. Since budgets were required to be spent according to chapter allocations, facilities could not use their resources most cost-effectively. Provider payment reforms currently underway in Kazakhstan and Kyrgyzstan focus on introducing competition among health providers by moving from centrally planned budgets to payment for services provided, and allowing facilities greater control over the utilization of their resources.
- *Restructuring service delivery by strengthening the primary care sector.* One of the most profound inefficiencies in the health care system is the imbalance between the hospital and primary care sectors. Formerly, the organization and administration of service delivery was also heavily biased toward centralized command and control. Clinical and management decisions were not based on health outcomes-based standards, but rather on legalistic targets and quotas and static norms of treatment. A major objective of the *ZdravReform* Program is to reorganize the system of primary care in urban and rural areas. In urban areas, this means creating new organizational units, or Family Group Practices (FGPs), preferably located in the community. FGPs consist of therapists (internists), pediatricians, gynecologists, nurses, and a practice manager, and can receive some variation of per capita payment based on the number of patients they register in their group. In rural areas, the units would consist of SVAs (rural ambulatory clinics) and FAPs (feldsher-midwife points). In Kyrgyzstan, a performance-based physician payment system is also being implemented to encourage primary care physicians to treat patients more appropriately and manage their practices more effectively.

1.1 Fieldwork Preparation and Summary of Scope

Advanced preparation for the field work was mandatory as a wide number of subjects needed to be reviewed during the very brief period of field work. To assist in this preparation, the AICPA Auditing and Accounting Guide² was used as a vehicle to methodically touch on the majority of key accounting and auditing issues related to health care organizations. In addition, the field work relied on other standards of accounting such as the basic AICPA Generally Accepted Accounting Principles (GAAP), and the AICPA Generally Accepted Auditing Standards (GAAS) as additional resources. This helped to guide the field work in a consistent and predictable fashion and expedite the process.

² See Appendix for *Documents Used*

The following subjects were specifically addressed in the field work through contact with administrative, economic, and accounting counterparts at the Oblast Health Administration in the Issyk-kul Oblast as well as the financial staff of the Oblast Government, Karakol City, and selected accountants within the FGPs:

- Financial accounting systems
- Internal control systems
- Auditing systems
- Management systems

It was also not the intent of the field work to change the local financial accounting system to mirror the American system. Rather, because the American accounting system has dealt with issues such as health care case based transactions, including insurance funds, American standards were compared to the host country to promote an understanding of many complex issues. It is hoped that an identification, understanding, prioritization and resolution of these issues will lead to:

- Improved financial accounting methods for the MHIF to better support management decision-making;
- Improved internal control and auditing methods for the MHIF staff; and
- Improved management systems that promote efficiency and effectiveness in the operation and performance of the MHIF.

After a two-day orientation in the *ZdravReform* office in Almaty, the field work began in Kyrgyzstan, which is currently experiencing a crisis in funding the health sector. Nine calendar days were spent in Karakol.³ Because of the inter-relationships between the MHIF and the dependent providers of care, the field work was accomplished with an eye on how the recommendations of this work would affect related entities⁴. As such, numerous references to the accounting structures and needs of these organizations are also noted.

The consultant then returned to Almaty and, while scheduled to continue in Zhezkazgan, ended up staying in Almaty working with the Federal Fund due to a scheduling conflict in Zhezkazgan. The *ZdravReform* Program is currently targeting Zhezkazgan and Semipalatinsk Oblasts with coordinated technical assistance in health insurance, provider payment, and service delivery reforms. In these oblasts the MHI Funds and Oblast Health Administrations have been able to minimize political conflict and achieve significant

³ In regard to the field work in Karakol, in a matter of a few days it was impossible to accomplish a comprehensive evaluation of the financial accounting system of any nation. This was not the intent of the field work. Rather the intent was to look at key areas of the local financial accounting methodologies and techniques being employed in the Oblast Health Administration of the Issyk-kul Oblast, located in the City of Karakol, and make a prefatory assessment of how these techniques would serve the management of the Mandatory Health Insurance Fund (MHIF). This fund currently exists and, in fact, there is an accounting structure monitoring the Fund. However, the fund is currently not acting as a source for full or partial capitated payments to fundholders. "Full fundholding" is intended to occur in the near future.

⁴ This includes the Family Group Practices (FGP) and the current three hospital-based providers of inpatient care

progress on ambitious reform agendas. Progress in this region precipitated the *ZdravReform* Regional Director to request the current field work by the consultant in Issyk-kul to be expanded by one week (through November 27) to this region. This was to include training in management accounting principles in Zhezkazgan. The effort was redirected to the Federal Insurance Fund in Almaty, where three training/workshops were provided in a three-day period, attended by approximately 55 participants.

2.0 FINANCIAL ACCOUNTING

STRENGTHS, WEAKNESSES, AND RECOMMENDATIONS

2.1 Accounting Summary & Conclusions

It is easy to identify weaknesses in any accounting system. However, of all of the issues observed, none should preclude the MHIF from using existing financial accounting tools and techniques to begin the process of fundholding as long as the process is somewhat phased in and a reasonable plan is simultaneously implemented to improve the accounting system in concert with the Oblast Government (Department of Finance and the Audit area). If the implementation process is phased and coordinated with such a plan, the financial risk and timing issues of fund payments and cost incurrence will be diminished and the reaction time of management to respond to weaknesses in the accounting system will be increased.⁵ Starting the fundholding process with three FGPs, for example, will actually assist in the development of more meaningful accounting records and processes for both the MHIF and the FGPs.⁶ From there, an additional 20 or 30 FGPs could be phased in to partial fundholding and would benefit from the experience and accounting system development that was tailored during the initial three FGPs start-up. This will facilitate the implementation process, better focus limited funds for technical and implementation assistance, as well as better define and prioritize the various training needs for both the MHIF and the fundholders.

The major weakness of the current financial accounting system is its strict adherence to selected forms which do not adequately meet the needs of the MHIF⁷ and the manual nature and strong orientation for reporting to outside authorities rather than internal management. Additionally, the system does not easily report accrued expenses in a fashion that easily advances a manager's understanding of the financial health of an entity. The system simply is not "user-friendly" for managers desiring consistent monthly reports representing a full economic picture of the entity so that proactive decisions can be made on a timely basis. The situation is complicated by funding and payment cycles that have

⁵ This will also provide time to coordinate with the Oblast Government, including the Inspectorate responsible for external auditing. There is a need to insure current external regulations, many of which are in conflict with the MHIF concept, do not interfere with the process of revising such regulations so as to promote MHIF success. This will require a cooperative environment with the authorities and a pilot period is seen as an ideal way to provide for this.

⁶ This same rationale applies to the development of internal controls.

⁷ Nor the FGP's or other providers

been historically erratic in their timing. This has caused and will continue to cause lags in reporting and frequent mis-matching of costs with related revenues. As a result, managers will be precluded from having visibility of the economic health of an organization except in rather lengthy (six-month) retrospective views. Because of the changing economic situation and the newness of the MHIF, it is recommended the MHIF management have better and more frequent visibility of operations. This requires some slight adjustments in accounting methods and reporting formats as well as some training on the role and use of such accounting information in guiding the MHIF.

Because financial accounting is a regulated activity, it is recommended that *ZdravReform* assist the MHIF in producing a useful management accounting computer program. The program would take fundamental financial accounting information such as the balance sheet, and facilitates the maintenance and preparation of this key report. This would save counterpart time and improve accuracy while providing flexibility for internal management to manipulate the accounts to easily include accrued costs and incorporate key operating ratios, trends, and other indicators that relate financial performance with operational outcomes. This will enhance not only the accounting function but internal control, internal and external auditing, as well as various management systems such as budgeting, cost accounting, and performance management.

2.2 General Accounting

Financial accounting systems are traditionally geared toward external users of financial data such as tax authorities, external auditors, banks and governmental authorities. Management accounting systems are geared toward helping management lead the organization to maintain day-to-day viability.⁸ Consequently, financial accounting is a regulated reporting scheme that typically does not serve internal management very well in the ongoing day-to-day management of an entity. This is the case with the MHIF. Worrying about the financial accounting system, per say, except in regard to how it can be used/adapted to produce useful internal reports for the management of the MHIF, is of marginal short-term benefit to the reform effort.⁹ The question is, *how can the current financial accounting system be adapted to rapidly produce a useful internal reporting*

⁸ This is not just financial viability. In fact, all of the recommendations in this report are inter-related. The accounting recommendations impact the internal control issues which in turn impact the management systems. As such, it is not uncommon to find a "management systems" type of recommendation in the accounting section. After all, accounting is merely another information system.

⁹ However, there is a need to revise the current external reporting scheme that will allow the Health Authorities to have an adequate understanding and control of these public funds. Because the current reporting requirements are defined by articles, and the MHIF fundholding arrangements are by definition not provided by article, revisions will be required. The revisions are suggested to be outgrowths of the internal reporting scheme which is recommended to be developed in a 90-day period. It is suggested this be coordinated with the Oblast Government authorities during and after the initial 90-day experiment, so proper regulations can be written and officially published. This will better position those wanting to "roll-out" this program. Failure to do this will result in having to redefine the external accounting needs within each and every oblast.

*system for management? Then, how can these methods be used and audited to adequately provide external users with sufficient information?*¹⁰

The current financial reporting system is not easily producing useful management information. This translates to the fundamental recommendation of this field work related to the accounting systems: Management needs to take what financial information is available, automate selected aspects of it so as to minimize double accounting work, add a few selected accounting features, and improve the frequency and completeness of the reporting capabilities that give immediate insight into:

- The current and historical sources, timeliness and amounts of fund inflows;
- The current and historical recipients, timeliness and amounts of fund outflows;
- An understanding and ongoing reconciliation of the relationship between the fund outflows and the delivery of care; and
- The current and historical tracking of meaningful measures of operating performance such as ratios and key indicators that provide insight into the ongoing fiscal health of the MHIF.

As indicated earlier, most financial accounting systems¹¹ are developed according to the regulatory requirements of external authorities.¹² In the case of the MHIF, the accounting forms and methods used in what has been described as *Soviet-styled* accounting are not normally negotiable. They are required by law and are frequently audited by external evaluation teams capable of employing punitive measures if the system is not adhered to in an accurate and timely manner. The difficulty for the MHIF lies in the fact that not all of the current regulations apply and that many of the current forms and regulations either need to be modified or do not exist. Consequently, the *ZdravReform* field staff felt a prefatory appraisal of the strengths and weaknesses of the current financial accounting system of the MHIF needed to focus on the where-with-all of the available reporting capabilities of the MHIF to serve internal management in carefully guiding the fund to a status of ongoing economic health.¹³ Where such a system was seen as, or likely to be inefficient, specific recommendations would be made.

¹⁰ A restructured delivery process demands that the restructuring first occur within the new entity and then external requirements are applied. To first apply external requirements which often do not apply nor support the new structure, would defeat/cripple the reform effort. As noted in an earlier footnote, cooperating with Oblast Governmental authorities in producing revised regulations which meet their needs and removes obsolete regulations not applicable to the experiment needs to be an ongoing aspect of the program. The field work found such a willingness within the Oblast Finance Department.

¹¹ Financial accounting is normally highly regulated. Management accounting is a field of accounting that translates financial accounting information (or creates new accounting information) into reports and analysis that are useful to managers within the organization. Management accounting is not regulated; rather it is "user-defined" to suit the particular needs of the organization.

¹² This includes the United States where GAAP, GAAS, the SEC, the IRS and many other regulatory bodies dictate with few exceptions how, when, and where financial reports will be submitted.

¹³ As mentioned earlier, it was not the intent of the field work to change the financial accounting system, as this is a regulated issue. Rather, it was to understand what financial information was being produced, and recommend methods for the management accounting system to supplement the financial accounting system for more complete reporting and analysis

A rapid evaluation of the current financial accounting system supporting the MHIF was then undertaken. The methodology employed was to review basic underlying principles and reports of western financial accounting systems and define the comparative strengths and weaknesses. The following is such an analysis.

2.3 Current Financial Reporting

Normally, the nature of an organization and its operating structure will have a significant effect on the types of reports that are required. In the case of the former Soviet Union, while there are a number of new accounting forms and techniques, particularly for those organizations that are "private" oriented, there is still, in fact, minimal variation in reporting formats that are readily suited to management needs.¹⁴ This is a weakness.

The Soviet-styled accounting system tends to be rather balance sheet oriented. In other words, the focus is on tracking assets and liabilities. These assets and liabilities are periodically measured on a given date and reported to higher authorities. As such, an orientation toward balance sheet accounting is "point-in-time" oriented. In other words, as of *"such-and-such a date, this is where the account balance(s) stood."*¹⁵ While a balance sheet accounting orientation is an important aspect of any accounting system, it is recommended to MHIF management that an accounting capability be established that readily:

- Describes the financial activity over a given period of time (e.g. not *point-in-time* oriented but *period-of-time* oriented...*how did we do during June?*)
- Explains how/why changes from one period to another period occurred...*Why did cash decrease from last month?*
- Tracks the sources and uses of cash and ensures management has adequate visibility of the liquidity of the organization to meet pending liabilities, given rapid changes in the operating environment....*To whom did the cash go? Do I have enough to cash to pay next week's bills?*

In other words, it is also important to be frequently monitoring and interested in how and why economic transactions resulted in the current balance sheet result. The Soviet-styled accounting system, coupled with some external analysis, is capable of such an analysis. However, due to the:

- Manual nature of most aspects of the system,

¹⁴ Part of the problem is that it is geared toward being accomplished manually. This issue alone precludes the manager from readily accomplishing what-if analysis, revising comparisons to see the data in "another light," etc. It takes so much effort simply to produce the reports that, by the time they are ready, the next period of operations has almost finished!

¹⁵ This is similar to the management of a personal checking account. Money is placed into the account (an asset) and taken out. At the end of a given month, a statement is issued indicating the resulting balance in the account.

- A number of economic transactions that were not normally reflected in regular/periodic accounting reports to internal management (such as depreciation, contingencies, accruals, estimations, etc.),
- The inability to readily coordinate the forms and reports necessary to complete such an analysis, and
- A cultural orientation that does not empower local accountants and managers to take on such an analysis (rather, it is often referred "upward" or "over" to the "economist" or to higher authorities),

...the task is rather daunting for most trained Soviet-styled accountants let alone a foreign accountant. This is a major weakness.

Complicating this situation was an observed mentality that does not adequately encourage or empower organizational accounting or economic managers. There seems to be an historical message from Soviet times that accountants within organizations are "to record economic transaction events" to "higher" authorities in predefined accounting forms and formats and they, the higher authority, will (eventually) make decisions. Recommendations can be given and occasional special analysis might be developed by an economist, but those recommendations are often dependent on limited time, access to data, or familiarity with the subject.

Unfortunately, when an organization is undergoing change, it is of vital importance for organizational managers (both accountants and economists) to have active and sufficient insight into operations on a *frequent* basis to be constantly making or recommending mid-course corrective actions. Consequently, a major weakness in the Soviet-styled financial

Recommendation for the MHIF

Begin targeted training to the MHIF and supporting providers in the essential tools and techniques of management accounting with a focus on how to better understand and manage the performance of an organization. This would include an initial training seminar of one week, followed by counterpart customization of the issues. Such training has been developed by ZdravReform staff in other parts of the former Soviet Union and can easily be adapted to the situation in Karakol. Training in this subject area has been shown to be useful for both changing the management culture as to the role and application of such information, as well as useful in defining new tools and techniques for operational analysis related to organizational efficiency and effectiveness. It has been observed that any orientation toward management accounting in the former Soviet Union does require some time for the participants to internalize the value and role of the information within their organization. After all, this is a management culture change. Consequently, the earlier this is started, the better.

reporting system seems to be the inability to rapidly assemble a complete financial picture of an organization for interim periods of time that can readily be used to make management decisions which change the financial course of the entity in a positive way and in a prospective fashion. In other words, it is recommended:

Where to start this process is a judgmental issue. The following is recommended as a primary goal.

The above recommendation would equally apply to the FGP's and the hospital based providers. The differences in the reporting statements would be the nature of the information being reported within each statement.

2.4 Basic Financial Accounting Principles and Essential Concepts

Selected (basic) financial accounting principles were addressed in the field work. Specifically, GAAP¹⁶ principles were used as a baseline for analysis. Not all of the potential principles were evaluated because it was felt some were more germane to the MHIF and needed immediate attention. An explanation of each principle addressed, as well as a few selected concepts in the field work, is provided below. An analysis and recommendations are included.

2.4.1 Matching—What it is and why is it important? (with comments on Consistency and Accrual)

The *matching* principle in most western accounting systems dictates that inflows of money (revenue) be matched with related costs for a given period. If inflows of money (revenue) are deferred to a future period, the matching principle dictates that any accompanying costs

¹⁶ GAAP - Generally Accepted Accounting Principles. GAAP offers a well published and known baseline of standards for financial accounting. It was hoped that, by using such a comparison, future comparisons would be facilitated.

related to that inflow flow also be deferred.¹⁷ One primary benefit of the matching principal when applied in an accounting system is that it promotes more consistent comparability among accounting periods. Consistent comparability is important in that it provides more useful reports for internal and external decision-makers to make rational judgments and operating decisions when guiding the organization(s).

Without *matching*, the monthly¹⁸ interim financial statements employed by most management teams might not offer comparable reporting. This could lead to managers under or over estimating their financial position for a given period of time, or simply not understanding the true economic stance of the entity.¹⁹ This would diminish the usefulness of such reports to provide meaningful insight to the managers of the organization(s). Considering the need to manage such a new fund in a proactive manner, and given the rather dynamic nature of the deteriorating economy in Kyrgyzstan, the lack of matching could cause a manager to erroneously believe the organization is in good financial health.

A common example of matching is the treatment of depreciation in western countries. For example, assume a \$5000 asset was purchased and is to be depreciated 20 percent each year (\$1000 per year). In this case, \$1000 of depreciation expense is posted against earnings each year so as to consistently match the earning power of the asset with the period in which it is employed. As each \$1000 of depreciation expense is posted, the value of the asset on the balance sheet declines by an equal amount. Consequently, the balance and activity statement of the entity together present a fairer picture of the economic position and activity of the entity. The current accounting system does not recognize depreciation as an expense, only as a contra-account to the value of the asset.

The notion of accrual is related. Accruing costs into a financial period is done so that the financial picture of the period under review shows a more complete picture of economic activity. For example, costs that are incurred but not paid and/or reported, might typically be accrued into the period in question. (This means they are reflected as a liability in the financial reports.) Even though the cost has not been paid and, in some cases, not even reported to them, managers do this so they can obtain a more complete picture of the operating month. This avoids "surprises."

¹⁷ The matching principle can require estimations of either costs or inflows of revenue on the part of accountants. Estimations require judgment and thus, if material, should be subject to periodic audit review to ensure the estimations are reasonable. Reasonability can be determined by a number of common methods including benchmarking, historical trends, etc. This subject is discussed in greater detail under "Materiality."

¹⁸ Monthly periods are only one example. In fact, any period of time, such as quarterly reporting or yearly reporting, would be affected. The longer the time span or "period" of reporting, the less likely the matching principle would affect day-to-day decision making. However, with the creation of a new enterprise such as the MHIF, there would be a need to monitor this fund rather frequently. This would require a frequent interim reporting capability such as monthly reports.

¹⁹ Remember, the MHIF fundamentally changes how funds are managed and shifts management responsibility of those funds downward, toward the providers. Thus, the financial accounting systems must better (more easily) support such management, including ongoing assessments of the economic picture of the entity. Previously the picture was controlled and visible only by the highest levels of government. The current accounting system (budget by strict article) prevents providers from using funds in any discretionary manner.

In the case of the MHIF, case based costs will be incurred by the providers for a given period and the bills will later be submitted to the MHIF. MHIF accounting for these costs can be done in two ways. The MHIF can wait until it receives a bill from the provider and then pay the case based cost as agreed. Or, the MHIF can accrue an estimate of the costs during the period when the costs are actually incurred, and then, when the bills are received, match these bills against the accrued costs for the period. The MHIF might owe more or less than the accrued amount depending on the accuracy of the estimate. (The estimates tend to be rather good after a historical baseline is established) By accruing these costs, the MHIF can be better positioned to monitor the inflows of money that are sufficient to manage the outflows of case based costs for any given period. The use of accrual techniques does not affect the flow of cash except that it would help prepare MHIF management for their cash responsibilities (commitments) in the future.

The specific concern for the MHIF is that fund managers will not proactively realize there is a creeping tendency to fall further and further behind in their financial commitments. Patient costs often cover extended periods of time. Even though the MHIF is not liable to pay these costs until they bills are submitted, it would seem appropriate to begin to estimate what these costs are in advance of the bill submission. Because accruals were made, when the actual bills come into the MHIF, an evaluation can occur that compares the expected amounts with the actual amounts. This promotes internal control of the limited funds by provoking questions as to why the amounts were larger or greater than expected.

Given the frequent tendency to pay late, experience delays in money transfers, inflation, and other factors that cause variability in the flow of funds among and between entities in a consistent and periodic manner, the need to have a financial accounting system capable of easily accounting for and reporting these variations in a straightforward and periodic manner seems clear. Lack of such an ability would limit the assembly of meaningful reports to retrospective reviews, based at best on quarterly reviews, and most likely only on six-month reviews.

While there are selected forms and methods within the former Soviet system to account for issues of matching, as well as accruals, there is not a comprehensive methodology to coordinate these issues within a single set of financial statements in a timely basis.²⁰ The older manual Soviet accounting system was not geared toward having short term, periodic looks at complete financial pictures for interim operating cycles within an organization. Rather, the focus was on centralized control and evaluation with excessive statistical and bookkeeping tabulation at the entity level. During the field work, the only way such an analysis could occur was to track number of different forms and externally attempt to formulate a set of documents that considered the matching principle. The process was fraught with questions and difficulties and extremely time consuming. In fact, the

²⁰ In fact, there was no easy facility to account for accruals regarding the inflow of moneys, such as receivables. This would need to be established.

consultant was never able to see the entire picture as to how this might be done solely using existing accounting tools.

The field work did reveal counterpart interest in addressing these issues so more meaningful periodic reports could be maintained. However, the field work also revealed a concern by the counterparts for inheriting additional work and a clear need for training as to how such reports could be used for making decisions during interim periods²¹. There was a consensus of opinion regarding the likelihood of changing the regulatory nature of the current financial accounting system to be close to nil in the next five years. Thus, the immediate and mid-term solution (five-year) to this issue was deemed to lie outside of the purview of the highly regulated and institutionalized Soviet financial accounting system. The following recommendation is then made.

²¹ This refers to the field of Management Accounting

2.4.2 Materiality—What it is and why is it important? (and the concept of Estimates)

Evaluations and decisions in financial reporting are normally based on how material the information is to fairly representing the financial picture of an entity. In western accounting, issues of materiality involve professional judgment and allow a reasonable degree of discretion as to what should and should not be included in the presentation of financial statements.

In the case of the former Soviet style accounting system, there remains little discretion (room for movement) in this regard.

This is a concern because it requires bookkeepers and accountants to follow strict rules and regulations as to what financial information should be collected and how it should be presented. As a result, a great deal of time is spent by accounting staff maintaining records on accounting transactions that are not necessarily

Recommendation for the MHIF

Rather than trying to immediately change the current accounting system, look for ways to automate the more mundane aspects of the current system. This will free up accounting and analyst time to explore more important operational analysis. The earlier recommendation for an automated accounting system is an example of this approach.

germane to the financial health of the organization. The entire process needs to eventually be streamlined.

It should be noted the issue of materiality touches the heart of the challenge to change the management culture to allow for more empowered analysis by lower level accounting staff. Former Soviet-style accounting did not promote accounting "judgment." Rather, the system promoted rules and regulations followed up by strict (and potentially punitive) auditing techniques such as that still provided by the KRU or equivalent.²² This raises the issue of employing accounting *estimates*.

Estimates

The issue of materiality also arises considering the need for health care organizations under any potential capitated funding arrangements (or other risk-sharing basis) to provide estimates of exposed risk or liability on their financial reports.²³ Considering the principle

²² The KRU is an acronym for the "Kontrol'no-Revisionnoye Upravleniye" (Control and Auditing Department). This is a different than the GRU which is a military intelligence arm of the armed forces.

²³ Capitated contracts shift risk among the fundholders. Fundholders will occasionally be liable for selected patients who require more extensive care (and costs) than other patients. The costs incurred by these patients may "flow" across a number of accounting periods. Estimating this liability and reporting/accounting for the liability is a common concern for reporting health care financial information. Failure to account for such a liability (contingency) would underestimate the potential financial responsibility of an entity. In order to account for such liabilities, estimates and judgment must be employed. Should stop-loss arrangements be used with the MHIF as the risk-holder, then the MHIF would need to account for such liabilities. Finally, estimates by FGPs will need to be made each month in regard to how they will allocate the capitated payment among the numerous financial commitments they have including payroll, patient expenses, etc. Therefore, the role and flexibility to estimate is crucial for internal and external reporting.

of materiality requires professional judgment, as does any "estimate," a role for judgment and conservative estimation is a necessary part of enhancing the accounting system to offer sufficient grounds for managers to make more rational decisions related to potential liabilities and contingencies.²⁴ The understanding of this role and the tools to estimate such liabilities need to be produced.

Recommendation for the MHIF

The internal accounting system should include a capability to estimate and report liabilities incurred but not paid, including contingent liabilities, in a straightforward manner. Contingent liabilities need to be presented along with other liabilities so the managers of the MHIF can maintain an ongoing understanding of the risks that are presented. As capitation rates are re-negotiated or refined, consideration of exposed financial risks must be included in the calculation. The methods for determining the amount and timing of the contingent liability cannot be predefined. They must be left up to the professional judgment of an accountant or economist given the nature of the contingency.

In addition, because materiality and issues of judgment stretch the current accounting mentality and regulations, it is recommended training occur in this regard. Senior managers need to empower lower-level managers to rationally estimate or use judgment in internal and external reporting requirements.

2.4.3 Expense Recognition Principles

Expense recognition principles are not, in fact, underlying principles of accounting. However, they are very important and need to be mentioned in relation to the MHIF and supporting providers. Specifically, expenses should be recognized in the accounting system according to the following circumstances.

- Costs should be related to a specific inflow of money (discussed earlier under matching).
- If an asset benefits more than one period (is being depreciated, for example) this should be done in a consistent fashion over future periods.
- Costs should be recognized as an expense when they will provide no future benefit.

Expense recognition principles are emphasized because the consultant could not readily uncover any such guidelines or rules of reporting. However, these guidelines seemed to exist in the activities of the accountants. Because the MHIF and providers need to frequently and accurately report the inflow and outflow of moneys, when and how accompanying expenses of the fund are also itemized is equally critical. Specifically, fund

²⁴ Conservatism is, in fact, a basic principle of accounting. The principle holds that errors in any *estimates* that would affect the reporting of fund balances are better to understate rather than overstate the balance. Therefore, when estimating, accounting principles recommend to estimate on the side of cautiousness, rather than presenting an "optimistic" picture of the financial situation.

accountants should be prepared to not just include lump-sum payments to fundholders. Usually, there are other operating expenses of such funds. These might include

- Equipment purchases,
- Computer repair,
- Salaries for fund managers and staff,
- Office supplies,
- Publications, reports, copying,
- Internal auditing, and
- Bank charges.

Currently the MHIF does not contain or reflect any of these accounts. In part this is because the MHIF is not in operation. In part this is because the MHIF is currently restricted to funding only four articles.²⁵ This will likely change in the future, and thus preparation and understanding of expense recognition principles is recommended.

2.4.4 Basic Financial Accounting Principles & MHIF Payor Considerations

There are a number of methods in which the accounting system of the MHIF will need to pay (and therefore report such payments) regarding the providers of care. The method of payment will depend on the type of provider and the implementation phase in which the MHIF is involved. The following is a simplified breakdown of the phases showing the various payment methods which are targeted under the program.

- Phase I—Current situation—MHIF paying hospital, polyclinic, and FGP providers based traditional articles 1,2,9,10.
- Phase II—MHIF will pay a capitated amount to FGPs for outpatient services only, a case based amount for inpatient hospital providers, and a case-based or traditional article amount for polyclinics. (How polyclinics will be paid seemed to be still under debate by the counterparts.)
- Phase III—Full fundholding situation. MHIF will pay a capitated rate for all services to FGP's. FGP's will negotiate rates with hospital and polyclinic providers for inpatient and other ancillary outpatient services.

The various phases and types of payments are identified, as each represents slightly different reporting requirements of the financial accounting system. Incorporating accrual accounting tools will help to address each of the phases.

²⁵ The MHIF is authorized, but has not begun to fund Articles 1, 2, 9 and 10 (salaries, payroll taxes, food, and medicines). It is believed the fact that the MHIF is still part of the Oblast Health Care Administration also inhibits the sense of urgency to establish these accounts and prepare to treat the MHIF as an entity in and of itself. After all, the Oblast Health Authority already has these accounts setup in its traditional accounting scheme.

During Phase II, when retrospective case based payments are being made to hospital-based inpatient providers, the MHIF will need to report accrued, but not paid, patient services. Depending on the delay in bill processing, it might be useful to estimate patient services that are incurred, but not reported. On the other hand, during Phase III the MHIF will shift the majority of its financial risk to the FGP, (hopefully) lessening the need to show such an accrual with the exception of any agreed-upon contingent liabilities such as a stop-loss arrangement, an infectious outbreak, or mandated health prevention programs. Consequently, during Phase II, when case-based reimbursement is in place, the need for applying the matching, materiality, estimates, and consistency principles will be more profound. In all cases, if funding is sporadic and the timing of payments is not consistent, a similar situation can exist during all phases.

The next sections briefly review the specific treatment of a number of accounting concerns. These include the accounting for cash, receivables, payables, investments, property, contingent liabilities, and related organizations. The reader is encouraged also to review the Appendix, where a summary of filed notes indicating specific questions answered by counterparts are noted.

2.5 Cash and Cash Equivalents

The MHIF is still organizationally part of the Oblast Health Care Administration and currently manages only part of the total health care funds of the oblast. As a result, the MHIF can currently be looked at as a "special purpose" fund within the oblast, with restrictions as to whom and what can be paid out of the fund. Additionally, the MHIF has a number of funding sources and it is the Administration's desire to expand the sources of funds (cash) over time. All of this means there is a need to account for cash and report cash holdings considering two notions: first, the liquidity on the cash or cash equivalent; second, the source of the cash when that source restricts the use of the cash for specific applications.

Accounting protocols usually encourage financial reports to list cash or cash equivalents in order of their liquidity, with the most liquid first. The consultant encouraged the accounting staff to internally report cash in this manner. This method details-out the accounting records so managers can quickly see not just the total cash, but what cash is readily available to be employed and from what source if restricted. In addition, because some cash sources might require that it be used for very special purposes, these amounts are generally listed as "restricted" cash in accounting reports. This keys managers to a better understanding of the supply and availability of cash for meeting cash commitments.

All of these issues are likely to apply to the MHIF over time. Because sources of cash can range from oblast moneys to humanitarian aid, the various uses and restrictions and levels of relative liquidity would apply to the MHIF. All of these issues are currently be accommodated in one way or another within the current financial accounting scheme. However, the reports are not particularly clear to management decision-makers and do not facilitate an understanding of the cash position.

Recommendation for the MHIF

Unfortunately, there is little cash and what cash there is seems to be spent the same day, making the ongoing need for reporting cash currently minimal. None the less, it is recommended that the cash reporting format for internal management be modified to improve the presentation of the material. It is also recommended that Zdrav *Reform* staff work to allow the involved entities to maintain cash accounts in banks. This is not currently allowed except for particular circumstances but will be required as FGPs, providers, and even the MHIF attempt to stabilize the sporadic inflow of money by maintaining a small fund of cash resources.

In the case of FGP, when full-fundholding becomes a reality, it is likely that an FGP will occasionally act as an "agency" for the funds of other entities. For example, an FGP might hire an external group of ancillary services to perform services within the FGP. The FGP might collect fees for these services, and hold those fees until the FPG passed those payments to the hired service.

Recommendation for the FGP's

In the case of agency funds, the FGP could act as a collection "agent" for the cash funds and would need to account for this cash separately from other cash. As such, the accounting records would need to reflect this separation. Without such separation, the cash could be co-mingled, and FGP managers could allocate cash funds inappropriately.

2.6 Investments

Because of the current economic crisis, there is little extra cash for "investments." As such, this subject area was not particularly relevant at this time. Should investments occur, the MHIF will need to determine how to report those investments to management, including notes as to the relative liquidity of the investment. Alternatives related to valuation could include fair market value, original investment value with notes disclosing realized or unrealized gains or losses, etc.

The only "investment" that is likely in the short term would be a reserve fund established by the MHIF to help minimize the variability of fund flows or to prepare for a contingent liability. Because there is no such fund of material amount at the present time, the field work deemed it inappropriate to spend much time on this. Should this occur, however, it is recommended that the investment be reported at its original investment value with notes indicating the current market value and the time it would take to turn the investment into cash.

2.7 Receivables & Payables²⁶

Receivables might include amounts due for health care services from patients, other payors, employers, premiums from stop-loss insurance limits, inter-facility payments, or any amounts due from others. Receivables are usually recorded in accounting books on an accrued basis at their full face amount, and later, if the amount is deemed less than the full amount through a contractual allowance or a bad debt estimation, the amount is adjusted accordingly. Consequently, receivables would seem to apply to all parties including the MHIF, FPGs, hospital providers, and polyclinics.

The nature of receivables and the reporting of them generally requires accrual accounting as well as the use of estimations. Estimations would include estimates for bad debts, estimates for contractual allowances and more.

The current accounting system does not adequately address receivables but does address payables. Considering the need to manage the fund in an environment of unpredictable inflows and outflows of funds, both aspects need to be addressed in the accounting system. This should be a feature included in the computerized accounting capability.

2.8 Equipment (& Property)

The major concern regarding equipment (or property) is matching the cost of the equipment with the stream of earnings (income flows) the asset provides over time. This implies the need to depreciate or otherwise amortize the asset over time and match the depreciated expense with the period in question. The MHIF is not likely to obtain material equipment assets and so is unlikely to be affected by this issue in the short term. However, the FGP and other providers will eventually be affected by this, and these non-cash costs should be reflected in the accounting records in order to obtain a more complete economic picture of the financial performance for a given period of time.

Recommendation for the FGP's & Other Providers

Equipment and the resulting depreciated expense of the equipment should be matched with the funding stream it supports over time. The accounting information system should include this ability by creating such accounts that can be easily reported to management.

Caution should be noted, however, as the Soviet accounting rules often list asset lives at extremely long periods. Western accounting practices tend to be much more conservative and list such assets with shorter lives. The shorter life increases the depreciated expense, which lowers residual income. Consequently, before managers assume the depreciation expense is realistic, it would be useful to assess the accounting life that is being used as well as the rate of depreciation.

²⁶ One entity's receivable is another entity's payable. Thus the treatment of these issues is, in fact, rather similar. Payables, similar to receivables, should be accounted for and reported based on their relative term of payment (short versus long). Both payables and receivables employ the notion of accrual.

The current accounting system records assets and depreciates assets on the balance sheet only. This means there is no easy recognition to management of the financial contribution which the assets played in delivering services (including the cost of those services). Thus, it would be useful to include adjusting entries to the Soviet-styled accounting system, which minimally makes these figures readily available to management so they may see the entire economic picture of the period under study.

2.9 Commitments & Contingencies

Commitments and contingent liabilities can include potential losses, contingencies related to risk contracting, third-party payment and rate setting schemes including case based payments, and other commitments or guarantees to pension plans, operating leases, purchase commitments or loan guarantees. It is likely the MHIF will incur some sort of contingent liability and need to report this to management. It is also likely the FGPs will incur such liabilities under full fundholding.

Two types of contingency events are seen as likely. Each event needs to be accounted for in the accounting statements (one more formally than the other). First, those events that are required under the Soviet system. These might include stop-loss levels or other such reserve funds that might be mandated. Second, there will be another group of contingencies that are normally not required to be reported in the external financial reports, but managers might elect to account for them in the internal reports. In this way, management will have a very real sense of the levels of risks and contingencies that could affect the fund.

Recommendation for the MHIF

Accounting for contingencies needs to be reflected in the accounting reports and will usually require some degree of estimation. As such, a professional who is competent in the estimation process related to the nature of the contingency might be periodically employed. These could be anyone from actuarial personnel to an accountant. Estimations should be audited periodically by testing the process employed, perhaps having an independent assessment of the risk, and by reviewing, if available, empirical evidence such as historical events.

The current accounting system manages and presents these issues poorly. There is a capability to create a "reserve account;" however, none existed nor is there any money currently available to put in such a fund. It is recommended that the accounting system regularly report funded and unfunded contingent liabilities to management and that an ongoing estimation of such risks be documented on a regular basis to management.

3.0 INTERNAL CONTROL: *STRENGTHS, WEAKNESSES, AND RECOMMENDATIONS*

3.1 Internal Control: Summary & Recommendations

The control environment, structure, and procedures are lacking. While these issues can be remedied, the larger challenge is getting the management staff of the MHIF to understand the value and role of such systems. This will require a paradigm shift. The shift might be described as moving from *just being accountable to others to being accountable to ourselves*.²⁷ Because effective financial management of the MHIF will often depend on judgmental estimates and a proactive orientation toward fiscal responsibility, the need for an effective internal control structure is significant. Counterpart interest in this shift seemed to be sincere, and experience says the process can be successful. Essential to this change, however, is not just the establishment of the internal control policies and procedures, but the cooperative training as to what and why these issues are of value accomplished in an environment of senior executive commitment and support.

The constraints of this effort in terms of implementation will lie in the willingness and ability of the top management to see the benefit of delegation of control for improved efficiency and effectiveness. (See Internal Audit Section). Without this, the role of internal control would be marginal given the centralized management style in existence. It should be noted that overcoming this issue will be of central importance in rolling out the program, as it is expected to be a recurring challenge. The likely strategy to overcome this obstacle is to demonstrate to the senior manager that control is not lost by implementing *internal controls*. In fact, control is increased while enhancing operational efficiency and effectiveness.

3.2 Overview of Field Work Related to Internal Control

The field work attempted to obtain an understanding of the relevant internal control structure and determine whether related policies and procedures existed related to the MHIF. The field work did not attempt to audit nor determine the effectiveness of the controls. This would by definition involve an extended period of work including the testing and careful evaluation of the controls. However, one FGP was interviewed as a

²⁷ Current controls are externally applied. When they are not followed, punitive measures can be taken. Unfortunately, many of the controls are not related to organizational efficiency or operational effectiveness. Unless an issue was "covered" by an external control regulation, the field work did not uncover one internal control designed to methodically enhance operations for the sake of enhancement! Given that the restructuring effort will offer more fiscal flexibility and autonomy to providers and to the management of the MHIF, the need to change this paradigm is seen as critical. More fiscal flexibility and autonomy without internal measures to promote increased autonomy to promote efficiency and effectiveness, can likely result in an abuse of funds or in an excessive amount of external rules and regulations which could cripple the value of the restructuring effort.

sample entity regarding the internal controls that were set up within the FGP and the results are shown in the Appendix.²⁸

Specifically, the following was addressed in a general manner with the Chief Accountant of the MHIF regarding internal controls. Brief one-word answers are provided.

- Does an internal control structure exist? (No.)
- How does/will she know that all transactions are being included? (Only transactions on the required forms are included.)
- How does/will she know that all transactions are being posted in the right place? (Audited by external auditors once per year—no internal checks.)
- How does/will she know that all transactions are being valued correctly? (Based on cash. Only estimated are some selected expense accruals.)
- How does/will she know that all transactions are being presented/classified properly? (Not an issue, classifications are regulated. Otherwise it audited once per year.)

The notion and appreciation of internal control and its role in creating accurate financial and operating data is rather different than western norms. Yes, some internal controls were in place and there was a strict definition of who would do what, when, and how. However, there was marginal appreciation, and therefore interest, in how an effective internal control environment would can lead to operational efficiency and effectiveness. Rather, the role of controls were seen as external standards to be rigidly applied by others without regard to their value to monthly operational performance.

Key to an effective internal control structure are commonly thought to be three components. These are:

1. The control environment
2. The accounting structure
3. The control procedures

These three issues were addressed with the Chief Accountant and the resulting answers are shown below.

3.3 Control Environment

- Are there any written internal policies and procedures related to the Fund?
No
- What is management operating style?
Centralized, command and control

²⁸ The results indicate few known controls were as yet in place. The results also indicated there was little knowledge or awareness of the role or responsibility for these control indicating a need for training in this regard.

- What are the methods for assigning authority?
Centralized, command and control, not always based on expertise.
- Are there various external influences that may effect the operations and practices?
Yes, the Oblast Government, external auditors, political pressures.
- What have been the practices in dealing with control issues in the past?
Only in relation to external audits have controls been dealt with. No formal internal control policies internally developed were identified.
- Have they done any risk assessment of areas that are subject to control risk?
No. In fact, there was little understanding of the concept of risk. This responsibility was not seen as an internal concern, but one for external auditors.
- Have they implemented any control activities for the fund?
No
- Has there been any retrospective monitoring or auditing of the MHIF? Any planned?
No; None known.

3.4 Accounting Structure

- Are all transactions being recorded? How is this done...manually?
The fund is not really operating yet. All transactions are done manually.
- Is there a backlog? Describe the timing of the transactions.
Not applicable yet. There was only a slight backlog in the submission of bills.
- Do the transactions fairly measure the value of the services?
This was checked by the local Economist and her estimation seemed to indicate they were accurate. However, the field work has obtained some conflicting information in this regard, and this is still being evaluated. Specifically, the actual budgets indicated by the Oblast Government and the actual budgets reported as received by the Oblast Health Authority and providers did not initially agree. It is believed at this time that this is not a major issue.
- Are the transactions being posted into the appropriate time period?
Not applicable now. Under current accounting, the inflows are not posted "properly" according to western accounting standards.
- How will these transactions be presented in financial statements? On a balance sheet basis only?
Current financial statements are very balance sheet oriented. There is no current effective "statement of activity" and this needs to be developed. The accounts are waiting for the Authorities to issue forms and regulations.
- Are there other legal requirements that they must follow? (KRU)
Probably, but these are not defined.

3.5 Control Procedures

- How are transactions authorized?
The authorization procedures are highly centralized. The Chief Accountant and the Administrator have signature authority.
- Is there a segregation of duties?
No. The Chief Accountant also maintains the books. This is not a segregation of duties.
- Describe the documentation needed for releasing funds.
Signature by Accountant or the Administrator.
- Are there other safeguards over the adequacy of the use of assets?
No, other than the threat of external audit.
- Is there independent checks? How often? By whom?
Once per year by the Oblast Finance Department. They also audit steel mills or any other Government firm.
- What are the control procedures for cash?
Little cash managed except payroll. The Chief Accountant does this with staff assistance.
- What are/will be the control procedures for validating authenticity of bills?
They are reviewed by the economist; however, there was no defined criteria for determining authenticity. She only seemed to check the quantity totals and the batch totals. Not the appropriateness or the value.
- Control procedures for internal investigations?
Whenever the accountant or economist elect to do so. None were recently done. There was confusion as to why they would want to do such a thing.

3.6 Other

- What areas are at risk for accounting controls and reporting that you would like to see improved ?
No opinions.
- Is there specific training you would like that would be useful and appropriate?
Management accounting techniques. Analysis of financial data. Using the computer to do these things. Understanding the notion of risk with internal control.

4.0 AUDITING—STRENGTHS, WEAKNESSES, AND RECOMMENDATIONS

4.1 Overview of Recommendations for Internal Auditing

While the establishment and maintenance of a system of internal control is an important responsibility of management, equally important is a consistent methodology for evaluating whether those controls are effective and in place. While management can never fully

delegate its responsibilities or accountability, management can create an internal auditing function designed to augment independent and external auditors for the purpose of establishing and improving operational control procedure.

Internal auditing, therefore, is a systematic method for determining whether delegated responsibilities are being carried out as expected and whether policies and procedures are adequate and effective in order to achieve organizational objectives. Therefore, the objective of internal auditing is to assist members of the organization in the effective discharge of their responsibilities. In this regard, internal auditors furnish members with analysis, appraisal, recommendations, counsel, and information concerning the activities reviewed.

The current situation within all of the entities contacted during the field work indicates the internal audit function is non-existent. Only external auditors who test and evaluate the compliance with selected, and often non-published rules and regulations were identified. In this regard, it is recommended that an internal audit function for the MHIF be established, responsible for assisting both the fund as well as component providers during the experiment in enhancing the internal control procedures and policies by providing constructive feedback in a non-punitive manner. Later, such a group could periodically check and investigate and recommend corrective action for any issues of fraud or procedure compliance/improvement. It is also recommended that an internal audit committee be created among the various members of the pilot experiment who would test the procedures and policies implemented during the establishment of the internal controls.

4.2 Overview of Recommendations for External Independent Auditing

An independent function is useful because of the inherent potential conflict between the entity's management and the users of external financial statements. In the case of the MHIF and component providers, this group of external users is generally thought to be the Oblast Government, specifically the Oblast Finance Inspectors.

The role of the auditor can vary depending on the nature of the auditing engagement. Most auditing related to the MHIF is concerned with external regulation compliance and the determination of the existence of assets. Similar to many western auditing standards, the activity of these auditors can be described as:

- Ensuring that transactions are executed in accordance with the regulations and have been properly authorized;
- Ensuring that transactions are recorded per regulations
- Assets are sufficiently protected and accounted for; and
- The recorded value of assets, including liquid assets, equal the actual amounts.

Such audits are currently conducted by examining source documents and obtaining corroborative material such as bank statements, independent checks, etc.

The role of the Oblast Financial Inspectors, however, is to perform a combination of audit functions. In other nations, many of these audit functions are often retained as the responsibility of management and are audited externally on request or under special circumstances. These functions include an ability to evaluate the following, without necessarily allowing the provider insight into the criteria for evaluation.

- Operational oriented audits
- Performance oriented audits

Finally, in most western countries, the responsibility for the detection of fraud by external auditors is somewhat limited, the notion being that the auditors' real intent to ensure the financial statements presented by management can be deemed fair and comparable to similar institutions. In the case of the MHIF, the responsibility for uncovering fraud lies heavily on external auditors and even other external organizations such as the police.

The primary strength of the current auditing system is that it is centralized. The weakness of the current auditing method lies in the ability of the external auditors to properly evaluate the performance of an organization in relation to the other auditing functions. In addition, the role of the audit is very oriented toward compliance oriented rather than toward seeking an understanding of how well the financial information reports the financial condition of an entity.

Clearly, organizations such as the MHIF and component providers need to have a more comprehensive auditing plan than simply having external regulations audited periodically by external auditors who are not always intimate with changing health care processes. However, more controls are not enough. Organizations need to have an internal control environment, accounting structure, and procedures that augment, not substitute for external auditors. External auditors cannot be expected to take on management responsibility for operational performance. This is management responsibility. This points to a fundamental flaw in the current approach to auditing: Too much responsibility for auditing is relinquished to those outside of the organization.

To assist in this effort it is recommended that selected auditing external procedures be established for areas of the MHIF that have greater financial risk than others. For example, auditing guides and steps for cash, key assets, receivables, payables, expenses, and special liabilities need to be established. An example of such a guide is shown in Appendix C.

While there were many questions asked related to the auditing function, the following questions represent key areas that answer many of the most commonly asked questions.

- Who audits you?
The Oblast Finance Inspectors

- To whom do they report?
The Oblast Finance Department
- How often does it audit?
About once per year.
- What are typical results of the audit?
We have not had problems. If there is an issue, we correct it right away.
- How often have procedures been revised?
We do not know. In fact, we often do not have insight into what the regulations are.
- Do you have a copy of the regulations on which you are held accountable?
No. We do not keep them. They change and we are not told of the changes.
- What will be the audit teams priorities/risk areas in auditing the MHIF?
We are never told this. They just do it.
- Do you ask?
No.
- Will they verify the existence of assets?
Yes. They might check some. They are more interested in if the paper work is correct.
- Will they evaluate the authenticity of bills?
I do not know. That is my job (the economist). There are no rules for the MHIF. That is what we are waiting for.
- Will they identify areas of possible fraud?
What do you mean? Of course they look for things that are not right.
- Will they be involved in operational auditing of member providers? Will they assess the effectiveness of management?
- *They can audit as they wish. They are the Inspectors.*

5.0 MANAGEMENT SYSTEMS:²⁹

STRENGTHS, WEAKNESSES, AND RECOMMENDATIONS

Supporting management systems that help to plan, organize, implement, and improve the fundamental management processes within the MHIF have not been created. Specifically, there was:

- No formal MHIF budget nor immediate plan to develop one.³⁰
- An organizational structure that was not operating as a discreet entity, without clearly defined areas of responsibilities to support staff.
- Minimal understanding of the role and use of cost accounting tools and methods appropriate for the MHIF.
- No existing performance management criteria for the MHIF other than gross measures, nor any immediate plans to develop them.

In part, this situation exists because the MHIF is new and its full structure still needs to be created. In part, this is because the support staff do not really understand what is expected of them and how to go about the development process, including when and where the process should begin. Therefore, the weakness of the management systems lies in the lack of such methods or systems.

The good news is that such topics could rapidly be learned in focused training sessions. Much of this material is available from other ZRP sites. In addition, there is adequate data to formulate a budget, along with performance criteria for many of the short term management needs. For example, a number of statistics are currently being collected at provider sites as well as within the Oblast Health Care Administration.

The larger and more important question is when should training occur, and then, when should such management systems be implemented? A material constraint in this regard is the period of time it takes for these skills to shift from conceptual notions to practical tools which counterparts can readily implement. In the case of the MHIF staff, this period is thought to be relatively short as long as they build on their computer skills. In the case of the numerous FGP's, this period would be longer due to the number of FGPs and the variety of skills found among the Practice Managers. Therefore, the following recommendation is made:

- Start training early. A one week training program is suggested.
- Select excellent pilot FGP sites with the knowledge and willingness to train other FGP based on their model. This will avoid "trail and error"

²⁹ Management systems in this document relate to budgeting, cost accounting, and performance management systems. The computerization aspect of management support systems could be called decision-support systems and is not within the scope of this document. However, as a brief note, it is felt the automation of selected accounting systems, combined with selected training on computer spreadsheets and data base management is sufficient effort at this point to support the emerging needs of the MHIF management.

³⁰ However, some economic analysis had occurred that could be used in a budget process.

approaches and provide more consistent and focused efforts at budgeting, cost accounting and performance management techniques.

- Complete the setup of a more functional financial accounting structure as discussed earlier in this document.
- Establish an internal control function.
- Then, hone management systems.

The management systems aspects is last on this list. This does not mean it is least important. Rather, there is a recommended critical path of activities which need to be done in order to create and maintain a useful management systems function.³¹

The reader is directed to the Appendix of this document for a bibliography referencing documents that would be extremely useful in providing training materials, example management reports, and other useful material produced by Wouters/Else during the past two years. Much of the material has already been translated into Russian.

³¹ In fact, there are certain aspects of management systems that would need to be defined early on. For example, establishing basic performance criteria is an integral part of establishing functional internal controls. You cannot control unless you have benchmarks of performance. This is an example of the interdependence of all of the topics discussed in this trip report.

Appendix A

LIST OF PERSONS CONTACTED

ZdravReform Evaluation Team

Rob Wilkenson, AID Evaluation Team leader

George Laudato, AID Evaluation Team Leader

ZdravReform / Almaty

Michael Borowitz, MD, Director ZRP Almaty

Sheila O'Dougherty, Deputy Director, Almaty

Andre Timoshkin, Computer Specialist

Zhena Samyshkin, Computer Specialist

Zhena Kutanov, Computer Specialist

Cheryl Wikham, ZRP Specialist

ZRP office staff

Karakol -Government and Oblast Health Administration

Dr. Dzeenbaev, Head, Oblast Department of Finance

Dr. Damera Salieva, Oblast Health Care Administrator

Dr. Kodjuble, Deputy Health Care Administrator

Ms. Gulnure, Chief Economist, Oblast Health Care Administration

Ms. Katchkiv, Chief Accountant, Oblast Health Care Administration

Ms. Oksana ?, Computer Specialist, Oblast Health Care Administration

Karakol - Oblast Regional Hospital

Dr. Medet Iyazaliev, Head Doctor

Ms. Tatianna , Chief Accountant

Other ZdravReform /Karakol

Dean Millslagle, IDS Site Manager

Karakol IDS Office Staff

Izat Bolponov, Practice Manager

Jylodyz Asanbekova, Practice Manager

Nurlan, Asankozhov, Practice Manager

Guljan Bekturova, Practice Manager

Bekdash Omurzakov, Practice Manager

Ashira Dzhudemisheva, Practice manager

Genadry Pleshakov, Practice Manager

Federal Insurance Fund - Almaty

Mr. Imanbayev - Managing Director

Mr. Ivonaev - Manager of Auditing Unit - KRU

Accounting Director

Also, see Kazakhstan list of attendees to the training seminars at the Almaty Federal Insurance Fund.

Appendix B

Daily Log

Saturday 10.26.96 - Flew from Kiev to Moscow. Layover in Moscow Airport was 8 hours. Flew to Almaty arriving at 0630 Sunday morning. Went to local hotel.

Sunday 10.27.96 - Day off. Read through task and did laundry.

Monday 10.28.96 - Went to ZRP office first thing in morning. Met with O'Dougherty, Regional Director and selected staff for the day. Reviewed the efforts being conducted in this region and prepared for the field work. Met with ZRP Regional Manager from 6 to 8 PM at the office and finalized agenda for the field work. Work is to be extended one week at his request to include a northern Oblast of Kazakhstan. (Zhezkazgan)

Tuesday 10.29.96 - Met with systems specialists in ZRP office and provided training on developing an accounting system capable of supporting an insurance fund. Reviewed key accounting issues with this staff in trying to identify the strengths and weaknesses of the current accounting system. Met with O'Dougherty in late afternoon and specifically reviewed scope of work for Karakol.

Wednesday 10.30.96 - Left Almaty by car at 0700 for Karakol. (Airport was closed for construction) Drive was about 700 kilometers. Arrived in Karakol at 1600. Found lodging in a "guest house" and returned to the ZRP office for a briefing with IDS Site Manager. (Dean) Discussed planned agenda, and arranged for next day appointments.

Thursday 10.31.96 - Met with ZRP staff first thing in morning and then spent afternoon with the selection of practice managers working with the MHIF.

Friday 11.1.96 - Met with Oblast Health Care Administrator in morning with follow-on meetings with the Economic staff of the Oblast. Arranged for Monday meetings with the Chief Accountant who was absent today. Began development of training materials for Computer Usage in Auditing, as well as training materials for Fraud Prevention for key ZRP staff.

Saturday 11.2.96 - Office closed. Worked in Guest House with the computer and translation staff all day. Developed accounting framework for interview on Monday. Finished some of the training materials.

Sunday 11.3.96 - Office closed. Worked in Guest House with the computer and translation staff all day. Developed internal control framework for interview next week.

Monday 11.4.96 - Met with Chief Accountant in morning of Oblast Health Care Administration. Met with Chief Economist in afternoon. Updated report in evening.

Tuesday 11.5.96 - Met with Dr. Dzeenbaev, Head of the Oblast Finance Department with IDS Manager. Discussion was very frank and constructive. He has some concerns. Was pleased with our approach and effort. Then met with a FG Practice Manager in afternoon.

Wednesday 11.6.96 - Met with Ms. Kachkyn, Chief Accountant at the Oblast Health Administration and reviewed accounting methods and approaches to the creation of a revised accounting system to better support the MHIF. Evening met with Dr. Brad Garrish, Family Practitioner in Karakol moving to Bishkek.

Thursday 11.7.96 - Met with Ms. Tatianna, Chief Accountant at the Oblast Regional Hospital and the Head Doctor. Discussed their accounting, reporting, and internal control needs

Friday 11.8.96 - Attempted to meet with Dr. Salieva as scheduled and update her on the week's work. She was out of town. Sent computer specialists back to Almaty. I stayed with IDS Manager to finish work and attempt to meet with Dr. Salieva.

Saturday 11.9.96 - Updated trip report in morning. Met with Salieva on Saturday afternoon. Meeting went well. Discussion was frank and constructive.

Sunday 11.10.96 - Left for Almaty by car on Sunday morning. 8 hour drive.

Monday 11.11.96 - Worked in ZRP Almaty office during the day. Updated O'Dougherty on Karakol issues.

Tuesday 11.12.96 - Worked with Computer Specialists on developing a functional accounting system for Karakol effort. Continued update and planning with O'Dougherty.

Wednesday 11.13.96 - Met with ZRP Regional Director, Visited National Insurance Fund for Kazackstan. Asked to stay another week and work the this fund and the Director General by ZRP Director.

Thursday 11.14.96 - Worked at National Fund all day. Met first with Imanbaev and then with the accounting staff, the statistical staff and the auditing staff. Met ZRP Bishkek staff in evening.

Friday 11.15.96 - Met with Imanbaev in morning and made preliminary recommendations for next steps. Asked by the Director General to meet with Chief Economist of the Fund in afternoon. Did this. Worked with Computer Specialists in between meetings. Asked by O'Dougherty to assist Bishkek office in setting up some basic office controls.

Saturday 11.16.96 - Prepared for presentations on Monday regarding internal control and fraud. Updated trip report.

Sunday 11.17.96 - Assembled material for Bishkek office and their supporting controls. Took off in afternoon.

Monday 11.18.96 - Met with National Fund Auditing staff. (17 attended composed of 6 doctors and 11 auditing and supervisory staff) Provided a presentation on preventing the opportunities for fraud. Updated ZRP office staff on activities. Worked with interpreter on preparing next days talk.

Tuesday 11.19 96 - Met with National Fund management staff and provided a presentation on internal control systems and methods. 15 attended. Met with ZRP Director.

Wednesday 11.20.96 - Finalized preparation for presentation for National Fund Staff on creating and applying financial management tools for improved resource control and management with providers. Delivered presentation in afternoon. Prepared summary sheet for Sheila.

Thursday 11.21.96 -- Left for Frankfurt.

Appendix C

Sample Audit Guide for External Auditors³² (Note how it is coordinated with internal efforts)

Accounting Assertion	Auditing Objective	Mgt. Control Procedure	Auditing Procedure
Test for the existence of the asset; Determine who has rights to the asset; Identify the value of the asset	To ensure cash, cash equivalents, and other such instruments are properly classified, described and disclosed in the reports	A responsible employee reviews the reports from banks, or equivalent organizations and attempts to determine these issues.	Verify the existence by confirming amounts. Test the valuation by comparing recorded values with market values or other values reported by outside groups.
Test for valuation, rights, and/or obligations in managing the asset	Funds are properly stated at their required value and any gains, losses and other material contingent liabilities are reflected.	Value of the fund is reviewed periodically (monthly) to ensure the balance is at the required and accurately reported level.	Confirm the value by checking the amounts. Review treatment of gains and losses to ensure they are properly classified and reported.
Test for accuracy and completeness in reporting the asset	Inflows and outflows are reported properly according to restrictions imposed on the account.	Periodic review of asset to insure compliance with any imposed restrictions.	Test the recording of selected transactions. Ensure amounts are properly classified per restrictions.

³² Adapted from the AICPA Accounting Guide Series, June 1, 1996.

Appendix D

Documents Used

Generally Accepted Auditing Standards (GAAS), The American Institute of Certified Public Accountants (AICPA) , 1995 Edition.

AICPA Audit and Accounting Guide: *Health Care Organizations*, American Institute of Certified Public Accountants (AICPA), June 1, 1996.

Management Accounting and Control: *A Manual for Health Care Organizations*, Else/Wouters, January 1996, Task 053, *ZdravReform*.

Development and Implementation of Financial Information Systems in the Ukraine: *A Manual for Health Care Managers* , Else, September 1996. Task 324, *ZdravReform*.

Strengthening Financial Management in the Ukraine, Trip Report, Else, August 1996, *ZdravReform*.

Cashin's Handbook for Auditors, Second Edition, James Cashin, McGraw Hill, 1986.

Fraud, Albrecht, Wenz, Williams, Irwin Press, 1995.

Appendix E

Training and Presentation Materials

- *Auditing in a Micro-Computer Environment: Considerations in the Design and Development of a Financial Accounting System - (1 page)*
- *The Nature, Symptoms, and Prevention of Fraud with a Focus on Lowering Opportunity- A confidential training session - (17 pages)*
- *The MHIF: Summary Recommendations for Dr. Salieva - (15 pages)*

Training Material

Auditing in a Micro-Computer Environment Considerations of the Design and Development of a Financial Accounting System

Understand the Control Environment

- Assess the organizational structure: Does the department that inputs and processes data on the microcomputer also authorize and execute the transactions?
- Assess the authority and responsibility of key employees: Are job descriptions clear and responsibilities defined? Is there adequate computer systems documentation indicating the procedures for authorizing transactions and approving system changes? Where spreadsheets are used, has an internal/independent auditor tested the template?

Understand the Accounting System

- Assess the methods in which accounting transactions are recorded, assembled, analyzed, classified, and reported for assets, liabilities, and residual fund balances. Can the system support two time dimensions...point-in-time and period evaluations? Is there a sufficient audit trail? Can you link source documents to micro-computer events?

Understand the Control Policies and Procedures

- Are the policies and procedures written?
- Are there adequate safeguards over access to and use of assets including micro-computers?
- Is there a degree of segregation of duties?
- Is the design of documents and records adequate?
- Are there periodic checks on the performance and proper valuation of recorded amounts?
- Is there a password security system on the accounting software? Are they kept confidential? Are they periodically changed?
- Are backups maintained off-site and exchanged on a regular basis according to a pre-defined policy?
- Is there a backlog of computer entries or documents?
- Are there safeguards for ensuring the data that is entered is complete and accurate? Are these safeguards sufficient? (Filters/reconciling batch totals, logic checks etc.)
- Is there protection from software viruses? Software piracy?

Typical Uses of Microcomputers in Audits

- Analytical procedures
- Trial balance and financial statement preparation
- Audit management including budgets, checklists, schedules
- Audit workpapers
- Audit sampling
- Data extraction
- Research—look for key words, titles, subjects

Characteristics that Distinguish a Manual Accounting System from a Computer System

- There is (must be) a transaction trail (A chain of electronic totals and events explaining the ending balances).
- Eliminates common clerical errors because there is uniform processing.
- Possible profound effect on the Segregation of Duties. (Need to monitor this)
- Increased potential for errors. Because fewer people are involved, an error can manifest itself over time
- Potential increase in the need for management supervision. Computers extend the ability of management to observe key ratios easily, obtain analysis, do "what-if" scenarios, etc.

Insert Fraud Training Presentation
17 pages

Insert Salieva Presentation
15 pages

Appendix F

Family Group Practice Managers *Observations of Where the FGP Practice Managers Spend their Time*

During the course of the field work, an extended interview with two Practice Managers was accomplished in Karakol. The intent of the conversation was to uncover the amount of time that was spent performing accounting tasks and provide insight into obstacles and opportunities in this regard. The Practice Managers cooperatively described eight categories of activities and verbally estimated the amount of time they spent performing these activities. While there was little scientific background to this interview, the results are cause for continued observation and perhaps action. The Practice Managers are major operational players in the management of the risk that will be shifted to the FGP's. The importance optimizing their time is seen as an ongoing concern for the success of the MHIF program.

Activity	Percent of Time Currently Spent on Activity	Percent of Time Desired to Spend on Activity
Scheduling	10%	5%
Bookkeeping and Accounting	40%	20%
Data Entry	35%	20%
Logistics	5%	5%
Training Others	2 %	10 %
Training Self	1%	10%
Analysis and Decision Support	7%	30%
TOTAL	100%	100%

The conclusions and observations of this interview were:

1. Practice Managers recognize their time management can be better apportioned. More time wanted to be shifted from tabulating data to implementing changes.
2. Practice Managers desire more automation of the accounting (specifically payroll) and scheduling, and continued improvement in the process of data entry. Data entry was described as two months in arrears.
3. Practice Managers currently keep no books other than payroll, thus indicating the current time distribution will get worse before it gets better as full fundholding will require Practice Managers to maintain a complete set of accounting records for the FGP.
4. Practice Managers did not know what accounting records would be required, nor how to fill them out. In preparation for fundholding, such forms would need to be identified, and a coordinated training program with the Oblast Health Care Administration would prove useful.
5. Proactive training and development time was marginally being accomplished and the Practice Managers perceive themselves as "learning as they go."
6. There was interest in providing greater degrees of *analysis* so as to promote the successful operation of the FGP. However, the Practice Managers could offer little recommendations as to how or what analysis they might offer indicating a need for training.
7. No cash was currently being handled within the FGP. All administrative work was paperwork oriented indicating an opportunity to apply computer technology to streamline such activity.
8. There are currently no internal control procedures, written or verbal, which seek to control, safeguard, value, or manage assets such as cash. There were written procedures for selected form processing, however.
9. Computer training in such programs as Excel and basic data base management would be useful to better empower the Practice Manager to resolve their own paper-chase challenges.
10. The Practice Managers felt they would be ready for full fundholding in three years. This indicated an expectation gap in learning and performance expectations as well as the need not to offer technical advisory assistance (per say) but to orient field work toward implementation assistance.

Appendix G

Recommended Format for Automated Accounting Structure

Permanent Accounts

$$\text{Assets} = \text{Liability} + \text{Fund Balance}$$

Concepts

- The MHIF should be a self-balancing fund because there should be a standard relationship between the assets of the fund and the liabilities and the residual fund balance. This is, in fact, a mathematical equation, (called the *accounting equation*) where assets will always equal the sum of the liabilities plus the fund balance. Each account within the asset, liability, and fund balance section of the balance sheet will have a tabulating total of the amount in the account. When all subtotals are added together, and the accounting equation is applied, Assets will equal Liabilities plus the Fund Balance.

Examples:

- If the MHIF receives 1000 som from the Oblast government, the cash account (an asset) would increase by 1000 and the fund balance account would increase by an equal amount.
- If the MHIF borrows 200 som, the cash account (an asset) would increase by 200 and the accounts payable account (a liability) would increase by 200.
- If the MHIF pays a capitated payment of 50 som to the a FGP, the cash account would fall by 50 and the fund balance would fall by 50.

Assets	=	Liabilities	+	Fund Balance
Cash Account +1000				+ 1000
Cash Account + 200		Account Payable + 200		
Cash Account - 50				- 50
Total 1150	=	200	+	950

The third example above illustrates a weakness in using only the balance sheet to track the flow of funds. The only visibility the balance sheet offers is the residual balances in each of the accounts. The reader of the balance sheet would not know who the amount went to, nor why. In order to provide insight into the activity of the fund over a period of time, temporary accounts can be used. Observe the following page with a revision to how the accounting system managed the third example above:

<i>Permanent Accounts</i>		<i>Temporary Accounts</i>
Assets = Liability + Fund Balance Expense)	+	(Fund Income - Fund

- *Permanent accounts* do not go away. The balances may change; example, cash, accounts that are payable, receivable, etc. Permanent accounts can be read by management at any point in time and the balances in each account can be reported. This is commonly called a "balance sheet."
- *Temporary accounts* serve to accumulate certain types of transactions for a given period of time such as a year. At the end of the year, the temporary accounts (Fund Income and Fund Expense) are matched against each other producing a net balance. This balance is "closed" or posted to the Fund Balance within the permanent account. When this "closing" occurs, the temporary accounts are once again at zero and the process starts again. The temporary accounts are commonly called an "income or activity statement."

Examples:

3. *If the MHIF pays a capitated payment of 50 som to the a FGP, the cash account would fall by 50 and the fund balance would fall by 50.*
4. *800 som of bills were received by the MHIF from providers. They will be paid at a later date.*
5. *The MHIF receives 400 som from the City Government.*
6. *The MHIF actually pays the 800 som it owed from transaction #4.*

Assets	=	Liabilities	+	Fund Balance	+	(Income - Expense)
1000						1000
200		200				
(50)						(50)
		800				(800)
400						400
(800)		(800)				
						1400
Closed						(850)
Temporary				550		
850		200		550		0
						0

Assuming every account is a unique account, at the end of the reporting period, the computer system can now make two reports. The first is the normal balance sheet. The second is an historical look at the activity of the temporary accounts. An example of such a payment might appear as shown on the next page. We will call it an "Activity Statement."

***Activity Statement
MHIF
For August, 1996***

Income to the MHIF

<i>Oblast Funding</i>	<i>1000</i>	
<i>City Funding</i>	<u><i>400</i></u>	
<i>Total Funding</i>		<i>1400</i>

Expenses of the Fund

<i>Capitated Payment to FGP #1</i>	<i>50</i>	
<i>Payroll to MHIF Employees</i>	<u><i>800</i></u>	
<i>Total Expenses of MHIF</i>		<u><i>850</i></u>

<i>Income in excess of Expenses and amount to be posted to fund balance</i>	<i>550</i>
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Now, imagine that each FGP had its own account number, as did each expense and income category. Over a period of time, the computer could easily sum each and every transaction type in the *activity statement* giving managers of the MHIF visibility into where the income went and from whom it came. Additionally, special reports can be written that describes the detail of all of the activity within each account over time. For example, the 50 som payment to FGP #1 might occur each month. The computer would record within the account each payment allowing the MHIF to see the total amount paid to FGP #1 over a year's time. At the end of each period, the temporary accounts would be closed with the residual balance forwarded to the Fund Balance in the *Balance Sheet*. Then, the computer would again begin to collect the transaction history for each account.

Finally, by making an inquiry into the cash account, a listing of all sources and uses of cash can be compiled. This explains to the MHIF management, where a vital asset was applied. When cash balances within the Balance Sheet are compared to a detailed listing of all accounts payable in the Balance Sheet, Managers can quickly obtain an understanding of how prepared they are to meet their financial commitments.

* Note:

Suggest Almaty staff first evaluate available Russian programs before developing new software.

Appendix H
Other Selected Field Notes

Other Questions asked to the Chief Accountant of the MHIF

(Answers are notes only, not exact words)

Is the fund operating?

Yes. It is not operating under fundholding, however. FGP's obtain their payroll funds from it. Providers obtain their articles from it.

Do you have separate books?

Some of them (accounts). We still use the normal accounting system.

What is the nature of this fund in your opinion? Business, not for profit, government?

Government. We want to run it like a business, I think.

Do you have a basic set of financial statements? Is there a statement of cash flows or statement of changes in fund balance? Statement of revenues and expenses?

Balance sheet?

Yes. We have a balance sheet and an expense statement. We also use a payroll statement. The others we do not have. These are the reports we also give to the Administrator as she must sign them.

How often are these reports prepared? Are they done manually?

Most are manual. Some are prepared monthly, most quarterly etc. It takes us about 10 days to compute them and hand them in. So, by the 10th we are done. That is when they are due.

Do you have a package of financial reports that are regularly given to the Administrator? Are they different than the required financial statements?

Yes and no. The Administrator must sign the reports and sometimes we perform an analysis for her if she asks for something.

Are there many requests?

No. Well sometimes.

Do you have the concept of accrual accounting?

Yes. We accrue expenses on the 2nd form. But we do not accrue inflows.

How often do you see the rates for billing in need of adjustment? Your guess? Would you know how to do this?

Not sure.

Are there other funds? Are they stated separately on the balance sheet?

No. This is the only fund.

Is there a hierarchy of accounting laws?

I guess that is the Oblast Finance department. We do not know these regulations.

Appendix I

Computer Systems—Laundry list of areas to consider for computerization

1. System to duplicate current accounting methods and incorporate recommended improvements for MHIF, FGP, and other providers
2. System to tabulate statistics
3. Systems to duplicate FGP registration forms (x3)
4. Automate FGP Payroll
5. Automate FGP Scheduling
6. Automate cash management for MHIF to help ensure timely payments
7. Automate how MHIF will allocate funds under fluctuations of monthly capitated amounts depending on availability
8. Automate statistical evaluations and analysis for internal and external auditing.

Appendix J

Summary of Recommendations for MHIF with Responsibles and Timeframes

See Kaztrp1.xls
(a 3 page spreadsheet)

Appendix K

Training & Presentation Materials for the Kazakhstan Federal Insurance Fund

- *Summary Observations for Managing Director of the Federal Fund*
- *Preventing and Managing the Opportunity for Fraud—Russian Version Only—17 pages*
Creating an Internal Control Structure—Russian Version Only—6 pages (Also handed out Management Accounting Manual)
- *Creating and Using Cost Accounting Information for Performance Management (An 85 page work book was prepared and distributed)*

Implementation Overview/Recommendations

Trip Report Karakol - B. Else
11/20/1996

Item	Description	November '96	December '96	January '97	February '97	March '97	April '97	May '97
1	Make Recom. for Acct. / IC / Audit / Mgt. Sys.	Brad						
2	Confirm & Reconcile Baseline Cost Data	Zhenia	Zhenia/Sheila					
3	Obtain/Identify Mgt. Consensus/Expectations	Dean						
4	Est. & Start MHIF Computer Training	Zhenia	Zhenia/Dean					
5	Start FIS Development - Andre	Andre						
6	1 Wk. Mgt. Acct. Training - 20 to 30 attendees			Brad/George				
7	Define Pilot Goals with Implementation Plan		TEAM					
8	Select 4 FGP's for Pilot Roll-out		Dean					
9	FIS/CIS Setup/Training			Andre	Andre			
10	4 FGP and MHIF Pilot Test				TEAM	TEAM	TEAM	
11	Hone Management Reports					George	TEAM	
12	Est. Int. Ctrl. Pol. & Proc.				Brad			
13	Est. Int. Audit Comm.				Brad			
14	Test Int. Ctrl. Pol. & Proc. By Audit Comm.						Brad	
15	Finalize Acct. /IC & Audit Functions						Brad	TEAM
16	Evaluate Pilot test and Formulate Next Steps						TEAM/Dean	TEAM/Dean